TRANSCRIPT OF RECORD

19

Supreme Court of the United States

OCTOBER TERM, 1928

No. 554 16

ELIZABETH C. TAFT, PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED SEPTEMBER 26, 1927

CERTIORARI GRANTED NOVEMBER 21, 1927

(33,006)

(33,006)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927

No. 554

ELIZABETH C. TAFT, PETITIONER,

vs.

FRANK K. BOWERS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF THE STATE OF NEW YORK

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

	Original	Print
Record from the district court of the United States, southern New York	1	1
Writ of error	1	1
Summons	3	2
Amended complaint	4	3
Motion to dismiss	10	6
Notice of motion to dismiss	11	7
Opinion, Knox, J	12	7
Order denying motion to dismiss	15	9
Judgment	17	10
Certificate of probable cause	19	11
Petition for writ of error	20	12
Assignments of error	22	12
Citation (omitted in printing)	24	
Stipulation re transcript of record	25	14
Clerk's certificate (omitted in printing)	26	
Proceedings in the United States circuit court of appeals, second circuit	27	14
Opinion, Manton, J	27	14
Concurring opinion, Hand, J	31	20
Dissenting opinion, Swan, J	33	22
Decree	35	24
Clerk's certificate (omitted in printing)	37	
Order allowing certiorari	38	24

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., DECEMBER 16, 1927

[fols. a-1]

IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

WRIT OF ERROR

UNITED STATES OF AMERICA, ss:

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the record and proceedings as also in the rendition of the judgment of a plea which is in the District Court before you, or some of you, between Elizabeth C. Taft, plaintiff, and Frank K. Bowers, Collector of Internal Revenue for the Second District of the State of New York, defendant, a manifest error hath happened to the great damage of the said Frank K. Bowers, Collector of Internal Revenue for the Second District of New York, as is said and appears by the complaint. We being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the Judges of the United States Circuit Court of Appeals for the Second Circuit, at the City of New York, together with this writ, so that you have the same at the said place, before the Judges aforesaid, on the 16th day of December, 1926, that the record and proceedings aforesaid being inspected, the said Judges of the United States Circuit Court of Appeals for the Second Circuit may cause further to be done therein, to correct [fol. 2] that error, what of right and according to the law and custom of the United States ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, this 17th day of November, in the year of our Lord one thousand nine hundred and twenty-six,

and of the Independence of the United States the one hundred and fifty-first.

Alex. Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, in the Second Circuit.

The foregoing writ is hereby allowed. Henry W. Goddard, U. S. District Judge.

[fol. 3] IN UNITED STATES DISTRICT COURT

L. 35, Page 86

ELIZABETH C. TAFT, Plaintiff,

against

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, Defendant

SUMMONS

To the above-named defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service. In case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness the Honorable Augustus N. Hand, Judge of the District Court of the United States for the Southern District of New York, at the city of New York, this 31st day of January, A. D. 1925.

Alex. Gilchrist, Jr., Clerk.

Cadwalader, Wickersham & Taft, Plaintiff's Attorney-. Office and Post Office Address: 40 Wall St., Borough of Manhattan, New York City.

[fol. 4] IN UNITED STATES DISTRICT COURT

[Title omitted]

AMENDED COMPLAINT

The plaintiff by her attorneys, Cadwalader, Wickersham & Taft, for her amended complaint respectfully alleges:

1. That the plaintiff was at the time of the beginning of this action a citizen of the State of New York, and a resident of the Southern District of the State of New York.

2. That the defendant was at the time the tax hereinafter mentioned was assessed and collected, and still is, Collector of Internal Revenue for the Second District of New York, and is an inhabitant and resident of the Southern District of New York.

3. That on or about December 12, 1921, plaintiff's father gave to her one hundred (100) shares of the common stock of The Nash Motors Company, a corporation organized and existing under the laws of the State of Maryland; and on or about March 18, 1922, he gave her fifty (50) additional shares of the same class and kind of stock of The Nash [fol. 5] Motors Company. Said shares were transferred on the books of the corportion to the plaintiff's name, so that on December 26, 1922, she was the owner of record of one hundred fifty (150) shares of the said common stock of The Nash Motors Company.

4. That on or about February 1, 1923, The Nash Motors Company declared a stock dividend of four shares of common and three shares of preferred stock on each share of common stock to stockholders of record on December 26, 1922. Accordingly the plaintiff received during 1923 as a stock dividend six hundred (600) shares of common stock and four hundred fifty (450) shares of preferred stock ot The Nash Motors Company, so that she then was the owner of record of seven hundred fifty (750) shares of common and four hundred fifty (450) shares of preferred stock of The Nash Motors Company.

5. That during the year 1923, and after the receipt of said stock dividend, plaintiff sold two hundred (200) shares

of said common stock and one hundred thirty (130) shares of said preferred stock of The Nash Motors Company for Thirty-four thousand three hundred forty-five Dollars and thirty Cents ($34,345.30).

6. That on or before March 15, 1924, the plaintiff filed with the defendant her individual income tax return for the year 1923, showing a net income of $40,972.75 and included therein the entire proceeds of such sale, to-wit, Thirty-four thousand three hundred forty-five Dollars and thirty Cents ($34,345.30).

7. That on or before June 13, 1924, the plaintiff paid to the defendant, under protest, the entire amount of tax cal- [fol. 6] culated to be payable on the basis of said return, to-wit, Four thousand three hundred twenty Dollars and fifty Cents ($4,320.50).

8. That the total market value of said one hundred fifty (150) shares of common stock of The Nash Motors Company received by gift by the plaintiff on the date that the said shares were so acquired by her was Forty-two thousand three hundred fifty Dollars ($42,350); that the proportion of this amount allocated according to the regulations of the United States Treasury Department to the two hundred (200) shares of common stock of The Nash Motors Company sold by her in 1923 is Six thousand three hundred six Dollars ($6,306), and the proportion of the said value allocated to the one hundred thirty (130) shares of preferred stock of The Nash Motors Company sold by her in 1923 is Five thousand four hundred two Dollars and eighty Cents ($5,402.80), in all Eleven thousand seven hundred eight Dollars and eighty Cents ($11,708.80).

9. Upon information and belief that the plaintiff's father, from whom she acquired one hundred fifty (150) shares of the common stock of The Nash Motors Company, acquired said stock as a bonus in connection with the purchase by him of shares of preferred stock of The Nash Motors Company at or about the time of its incorporation, in 1916, and the said common stock had at that time no market price or value in his hands, and on a subsequent sale of any of the said common stock by the plaintiff's father, he has returned the full proceeds of sale as income.

10. That the income tax paid by the plaintiff to the de-
[fol. 7] fendant on the said Eleven thousand seven hundred eight Dollars and eighty Cents ($11,708.80) thus included in her income for the year 1923, was Two thousand forty Dollars and nine Cents ($2,040.09).

11. That on or about June 13, 1924, and within the time prescribed by law, plaintiff duly took an appeal to the Commissioner of Internal Revenue by filing with the defendant a claim for refund of the said tax so paid, to-wit, Two thousand forty Dollars and nine Cents ($2,040.09), or such larger amount as is legally refundable.

12. That more than six months have elapsed between the time of filing the said claim and the beginning of this action, and no decision has been made by the Commissioner of Internal Revenue on said claim.

13. Upon information and belief, that Eleven thousand seven hundred eight Dollars and eighty Cents ($11,708.80), out of the proceeds of the sale of said two hundred (200) shares of the common stock and one hundred thirty (130) shares of preferred stock of the Nash Motors Company so sold by the plaintiff in 1923, is a return of capital, and is not income to the plaintiff.

14. That the assessment and collection by the defendant of an income tax of Two thousand forty Dollars and nine Cents ($2,040.09) from the plaintiff upon said Eleven thousand seven hundred eight Dollars and eighty Cents ($11,-708.80), was illegal, erroneous and contrary to the law and in particular to the Sixteenth Amendment of the Constitution of the United States.

[fol. 8] 15. That in so far as Section 202 (a) (2) of the Revenue Act of 1921 required that in computing gain from the sale of capital assets a donee of such assets must include as income any increment of value accrued before acquisition by such donee, it resulted in a direct tax upon capital without apportionment and was in contravention of Article 1, Sections 2 and 9 of the Constitution of the United States, and of the Fifth Amendment to the Constitution of the United States.

16. That no part of the said sum of Two thousand forty Dollars and nine Cents ($2,040.09) has been repaid to the plaintiff, and the whole amount thereof, with interest thereon from June 13, 1924, remains due and owing from the defendant to the plaintiff.

17. That this is a suit of a civil nature at common law, and the suit and cause of action herein set forth arises under the laws of the United States providing for internal revenue, and the Constitution of the United States.

Wherefore plaintiff demands judgment against the defendant for the sum of Two thousand forty Dollars and nine Cents ($2,040.09), with interest thereon from the 13th day of June, 1924, together with the costs and disbursements of this action.

Cadwalader, Wickersham & Taft, Attorneys for the Plaintiff. Office and Post Office Address: 40 Wall Street, Borough of Manhattan, New York City.

[fol. 9] *Duly sworn to by Elizabeth C. Taft. Jurat omitted in printing.*

[fol. 10] In United States District Court

[Title omitted]

Motion to Dismiss

Now comes the above named defendant by his attorney Emory R. Buckner, United States Attorney for the Southern District of New York and moves to dismiss the amended complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action.

Dated New York, June 25, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Office & P. O. Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 11] In United States District Court

[Title omitted]

Notice of Motion to Dismiss

Sir: Please take notice that the motion to dismiss the amended complaint herein upon the grounds that said amended complaint does not state facts sufficient to constitute a cause of action, made up and on behalf of the defendant under date of June 25, 1926, will be brought on for hearing at a term of the United States District Court for the Southern District of New York at the old Post Office Building in the Borough of Manhattan, City of New York, on the 20th day of July, 1926 at 10:30 A. M., or as soon thereafter as counsel can be heard.

Dated New York, June 25, 1926.

Yours, etc., Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Office & P. O. Address: U. S. Courts & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 12] To Cadwalader, Wickersham & Taft, Esqs., Attorneys for Plaintiff, 40 Wall Street, Borough of Manhattan, City of New York.

In United States District Court

[Title omitted]

Cadwalader, Wickersham & Taft, Esqs., Attorneys for Plaintiff (Henry W. Taft and Clarence Castimore, Esqs., of counsel).

[fol. 13] Baldwin, Hutchins & Todd, Esqs., Attorneys for Plaintiff (Robert A. Young and E. Raymond Shepard, Esqs., of counsel).

Hon. Emory R. Buckner, United States Attorney, Attorney for Defendant (Sherwood E. Hall, Esq., Asst. United States Atty., of counsel).

OPINION

KNOX, D. J.:

It is my opinion that no part or portion of the value of an outright bona fide gift as of the date of delivery is, or can, constitute taxable income in the hands of the donee. So far as the latter is concerned, the gift is a capital transaction. His liability for future income therefrom must be based on the value of the gift as of the time the transaction is complete, and not upon the cost of the property at the date of its acquisition by the donor. If the construction of the tax law, for which the Government contends, should be applied, it means that the donee of property is to be taxed upon an increment in value which, if it can be regarded as income at all, is income to another, viz.—the donor. A tax levied upon that increment in the hands of the donee necessarily results in a direct levy upon the gift. If the gift consisted of money, would it be argued that the donee is to be taxed on the difference in value of the money, that is, its purchasing power, as between the date of its acquisition by the donor, and the date of its delivery to the donee? I think not. The money would be regarded as capital in the hands of the donee; and so, I think that that which may be converted into money, as of the date upon which it is given away, must, so far as the donee is concerned, also be regarded as capital.

According to my views, the 16th Amendment to the Con-
[fol. 14] stitution conferred no power upon the Congress to tax gifts.

Very likely, it is possible to devise reasonably plausible arguments to the effect that what is transferred by the donor is nothing more than his original investment therein, and to cite various decisions which contain expressions that may be tortured to support the argument; but the fact remains that the common understanding of a gift is that the donee acquires, absolutely and completely, the entire value of the donation as of the date of transfer. Until a higher court than this is willing to endorse a different principle, I certainly shall not do so.

The motion to dismiss the complaint is denied and the plaintiffs may have judgment for the claim asserted against the Collector. He, of course, will be granted a certificate.

August 5, 1926.

(Signed) Jno. C. Knox, U. S. D. J.

[fol. 15] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER DENYING MOTION TO DISMISS—August 16, 1926

L-35, Page 86

Present: Hon. John C. Knox, District Judge.

The defendant above-named having moved this Court by Notice of Motion, dated the 25th day of June, 1926, for an order granting to said defendant judgment dismissing the Amended Complaint herein upon the ground that said Amended Complaint does not state facts sufficient to constitute a cause of action, and said motion having come on to be heard before Honorable John C. Knox, one of the Judges of this Court, on the 20th day of July, 1926 in the Court Room of this Court in the old United States Post Office [fol. 16] Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esquire, of counsel for the defendant in support of said motion and after hearing Henry W. Taft, Esquire, of counsel for the plaintiff in opposition thereto, and the Court after due deliberation having rendered its opinion on the 5th day of August, 1926 that the said Amended Complaint states facts sufficient to constitute a cause of action;

Now, upon reading said Notice of Motion and the said Amended Complaint and upon said opinion of this Court, all of which have been heretofore filed with this Court, and upon motion of Cadwalader, Wickersham & Taft, attorneys for the plaintiff, it is

Ordered that said motion to dismiss said Amended Complaint be and the same is hereby denied, and it is further

Ordered that the plaintiff may enter judgment against the defendant for the sum of Two thousand forty and 09/100 Dollars ($2,040.09), with interest thereon from the 13th day of June, 1924, together with the costs and disbursements of this action.

John C. Knox, U. S. D. J.

[fol. 17] IN UNITED STATES DISTRICT COURT

[Title omitted]

JUDGMENT

The defendant above named having moved this Court by a notice of motion for an order granting to said defendant judgment dismissing the amended complaint herein upon the ground that the said complaint does not state facts sufficient to constitute a cause of action, and said motion having come on to be heard before Honorable John C. Knox, one of the Judges of this Court, on the 20th day of July, 1926, in the Court Room of this Court in the old United States Post Office Building, Borough of Manhattan, City of New York, and after hearing Sherwood E. Hall, Esquire, of counsel for the defendant, in support of said motion, and after hearing Henry W. Taft, Esquire, of counsel for the plaintiff, in opposition thereto; and the Court after due deliberation having rendered its opinion on the 5th day of August, 1926, denying said motion on the ground that the said amended complaint states facts sufficient to constitute a cause of action and directing that final judgment should be granted in favor of the plaintiff for the amount de-
[fol. 18] manded in the complaint with interest, and the plaintiff having thereupon duly entered an order in the office of the Clerk of the United States District Court for the Southern District of New York on the 16th day of August, 1926, directing that said motion be denied and that plaintiff might enter judgment against the defendant for the sum of Two thousand forty and 9/100 Dollars ($2,040.09) with interest thereon from the 13th day of June, 1924, together with the costs and disbursements of this action; and the plaintiff having accordingly on the 19th day of August, 1926, served a copy of said order, with notice of entry thereon, upon the attorney for the defendant;

Now, upon motion of Cadwalader, Wickersham & Taft, attorneys for the plaintiff herein, it is

Adjudged that the plaintiff, Elizabeth C. Taft, recover of the defendant, Frank K. Bowers, Collector of United States Internal Revenue for the Second District of the State of New York, the sum of Two thousand forty and 9/100 Dol-

lars ($2,040.09), the amount claimed in the amended complaint herein, together with interest thereon from the 13th day of June, 1924, such interest amounting to Two hundred sixty-seven and 25/100 ($267.25) Dollars; plaintiff's costs having been taxed in the sum of Sixteen and 95/100 Dollars ($16.95); amounting in the whole to the sum of Two thousand three hundred and twenty-four 29/100 Dollars ($2,324.29); and that the plaintiff have execution therefor against the defendant.

August 20, 1926.

Alex. Gilchrist, Jr., Clerk of U. S. District Court for the Southern District of New York.

[fol. 19] In United States District Court

[Title omitted]

Certificate of Probable Cause

The defendant above-named having moved this court by Notice of Motion for an order granting to said defendant judgment dismissing the Amended Complaint herein upon the ground that the said Complaint does not state facts sufficient to constitute a cause of action, and said motion having come on to be heard before this court, and the court having filed its opinion and decision whereby said motion was denied and judgment was directed against the defendant personally, and it appearing that the money which said defendant had received from the plaintiff herein was paid by him into the Treasury of the United States in the performance of his official duty.

Now, therefore, pursuant to Section 989 of the Revised Statutes of the United States, I hereby certify that there was probable cause for the act done by the defendant Collector.

Dated, New York, August 25, 1926.

Jno. C. Knox, U. S. D. J.

[fol. 20] Consented to. Cadwalader, Wickersham & Taft, Attorneys for Plaintiff. Emory R. Buckner, U. S. Attorney, Attorney for Defendant.

IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR WRIT OF ERROR

To the Honorable the Judges of the District Court of the United States for the Southern District of New York.

Now comes Frank K. Bowers, the defendant herein, by his attorney, Emory R. Buckner, United States Attorney for the Southern District of New York, and feeling himself aggrieved by the judgment entered herein on the 20th day of August, 1926, in favor of the plaintiff and against him, by which it was adjudged that the plaintiff have and recover [fol. 21] of the defendant the sum of $2,324.29, and that plaintiff have execution therefor against said defendant, in which judgment and the proceedings had in this cause, certain errors were committed to the prejudice of this defendant, all of which more fully appears in the assignment of errors filed herewith;

Prays that a writ of error may be allowed to him from the United States Circuit Court of Appeals for the Second Circuit to the District Court of the United States for the Southern District of New York, for the correction of the errors so complained of, and that a transcript of the record, proceedings and papers in this cause, duly authenticated, may be sent from said District Court to said Circuit Court of Appeals.

Dated, New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Office and Post Office Address: U. S. Courts and P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 22] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENTS OF ERROR

Now comes the above named defendant by his attorney, Emory R. Buckner, United States Attorney for the South-

ern District of New York, and assigns error in the judgment of this Court entered August 20, 1926, in the following respects:

1. The Court erred in holding and deciding that the amended complaint stated facts sufficient to constitute a cause of action.

2. The Court erred in failing to hold that the amended complaint did not state facts sufficient to constitute a cause of action.

3. The Court erred in granting plaintiff's motion for judgment.

4. The Court erred in failing to deny plaintiff's motion for judgment.

5. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant for the sum [fol. 23] of $2,040.09, interest and costs, a total of $2,324.29.

6. The Court erred in directing the entry of judgment in favor of the plaintiff and against the defendant.

7. The Court erred in failing to dismiss the amended complaint.

8. The Court erred in failing to direct the entry of judgment in favor of the defendant and against the plaintiff, dismissing the amended complaint.

Wherefore defendant prays that said judgment of the District Court be reversed.

Dated, New York, November 15, 1926.

Emory R. Buckner, United States Attorney for the Southern District of New York, Attorney for Defendant. Address and Post Office Address: U. S. Court & P. O. Bldg., Borough of Manhattan, City of New York.

[fol. 24] Citation, in usual form, omitted in printing.

[fol. 25] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE TRANSCRIPT OF RECORD

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed on by the parties.

Dated, December 6th, 1926.

Cadwalader, Wickersham & Taft, Attorneys for Plaintiff. Emory R. Buckner, U. S. Attorney, Attorney for Defendant.

[fol. 26] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 27] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1926

Nos. 280-294

Argued May 20, 1927. Decided July 5, 1927

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

ELIZABETH C. TAFT, Defendant in Error (Plaintiff Below)

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York, Plaintiff in Error (Defendant Below),

v.

GILBERT C. GREENWAY, JR., Defendant in Error (Plaintiff Below)

In Error to the District Court of the United States for the Southern District of New York

Before Manton, L. Hand, and Swan, Circuit Judges

OPINION

In Error to the District Court of the United States for the Southern District of New York.

Actions by Elizabeth C. Taft and by Gilbert C. Greenway, Jr., against Frank K. Bowers, Collector of Internal Revenue, to recover for income taxes paid under protest. Judgments for plaintiffs; defendant appeals. Reversed.

Charles H. Tuttle, U. S. Atty., of New York City (Samuel C. Coleman, Asst. U. S. Atty., of New York City, of counsel), for plaintiff in error.

Cadwalader, Wickersham & Taft, of New York City (Henry W. Taft and Clarence Castimore, both of New York City, of counsel), for defendant in error Taft.

Baldwin, Hutchins & Todd, of New York City (Robert A. Young and E. Raymond Shepard, both of New York City, of counsel), for defendant in error Greenway.

MANTON, Circuit Judge:

These cases were argued together and will be considered in one opinion. The defendant in error Miss Taft received a gift from her father of 150 shares of the common stock of the Nash Motors Company—100 shares in December, 1921, and 50 shares in March, 1922. They were transferred on the books of the corporation in her name on December 26, 1922, when she became the record owner thereof. They were obtained by her father as a bonus in connection with the purchase of preferred stock of the Nash Motors Company. In February, 1923, the Nash Motors Company declared a stock dividend of four shares of common and three [fol. 28] shares of preferred on each share of common stock to the stockholders of record on December 26, 1922. As a result she became the owner of 750 shares of common and 450 shares of preferred stock. After the receipt of this stock, in 1923, she sold 200 shares of common and 130 shares of preferred stock for $34,345.30. The market value of her 150 shares of common at the time she received the gift from her father was $42,350. The stock which she sold in 1923 brought $11,708 more than it was worth when she received it. In making her income tax return and paying the same for 1923, she included the entire gain of the sale of the stock sold by her as income for that year. This was required by section 202 (a) of the Revenue Act of 1921 (Comp. St. § 6336⅛bb). She paid a tax upon the basis of the original return, and thereafter protested against the tax upon the

full amount of the proceeds, arguing that she should have been required to account, as income, for the difference between the value of the stock when she acquired it and the price at which she had sold it, to wit, $11,708.80.

In Mr. Greenway's case, the action is to recover a tax paid under protest as income tax for the year 1922, payment being made in 1923. The stock sold by this defendant in error was also a gift made by his brother to him. The stock was likewise sold at a profit.

The statute involved, section 202 (a) (2) of the Revenue Act of 1921, provides:

"(a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

"(2) In the case of such property, acquired by gift after December 31, 1920, the basis shall be the same as that which it would have in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts necessary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner."

A profit resulting from the conversion of capital assets is income, within the Sixteenth Amendment of the Constitution. Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 41 S. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305; Eldorado Coal & Mining Co. v. Mager, 255 U. S. 522, 41 S. Ct. 390, 65 L. Ed. 757; Walsh v. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762. Income from gifts is treated in the same manner as income from other sources, and income has been defined as gain derived from capital and labor or from both combined provided it be understood to include profit or gain through a sale or conversion of capital assets.

Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. The statute here attacked recognized this definition of income, and measures the profit or loss upon the sale or conversion of the gift as a difference between the price which the donor paid for it and the price which the donee obtained. The value of the property at the time the donor transferred it to the donee is ignored and Congress, in effect, charged the gift with the tax which the donor would have paid had he received the market value for it at the time of the gift.

The arguments of the defendants in error are that a gift is in the nature of capital assets, and that no tax is imposed upon the gift as such. The arguments further are that, by taxing as income the difference between the cost to the donor and the price, realized by the donee, the tax is being imposed upon the corpus of the gifts themselves, and that section 213 (b) of the statute (Comp. St. § 6336⅛ff), forbids this. But the question is whether the method adopted by Congress for measuring income is, in the case of the donee, a reasonable one in the aid of the purposes of federal income taxation. Section 213 (b) does not define what is income from a gift. The defendants in error accede to the position that what each received when they sold the property, if it shows an increase, is a profit; but, in measuring it, the price at the date each received the gift must be assumed to be its worth to them. But Congress has measured otherwise, and it says, in protecting the government against loss of revenue, it is proper that where the donee pays nothing, it accepts as a measure of gain or loss the cost to the donor without reference to its actual value when received by the donee.

[fol. 29] The obvious purpose of section 202 (a) (2) was to prevent the loss of income represented within the profit to the donor during the period he held the property before he made his gift. Congress has determined that this same increment shall be recognized as income, even though a gift intervenes. The transfer by gift is but a change of ownership in the specific property. In doing this, Congress imposes no tax upon an unrealized gain. The value of the property is ignored or not taken into account until the property is finally disposed of in such a way that it could be determined that the owner made either a gain or a loss,

and, until there is a sale, there is no necessity for measuring income, nor is there an opportunity to do so. This avoids tax evasion or tax avoidance. This statute puts the donee, who pays nothing for the property, and who therefore loses nothing, on any theory of economic principle, in the position the donor would have been, in so far as taxation is concerned.

Nor does this method of taxation suggest that the statute is unconstitutional, as in violation of the Fifth Amendment. While the power to tax is not absolute, a tax should be shown to be arbitrary and capricious before it is condemned. The power of Congress to tax as permitted under the Sixteenth Amendment must be recognized, as well as protection under the Fifth Amendment. The method of the statute which regards the corpus of the gift, irrespective of its value, as a thing which is transferred, is essential to the entire taxing scheme. The method results in no greater tax than that which would have been imposed upon the donor and the donee, if each had been asked to pay a proportion of the tax based upon the amount of the increment when in the hands of each. Only the income from the gift is affected by the statute. It is not the donee's income from other sources. The statute is prospective in operation, and relates to gifts made after a certain date. A donee must, therefore, be charged with the knowledge that under the law the gift may be worth less to him because of the necessity of sharing part of the profits with the government—that part which had accumulated up to the time he had received the gift. The argument against the constitutionality of the section loses sight of the fact that the statute is directed toward a means for collecting the revenue which is made available under the income tax statute. Knowlton v. Moore, 178 U. S. 41, 20 S. Ct. 747, 44 L. Ed. 969; N. Y. Trust Co. v. Eisner, 256 U. S. 345, 41 S. Ct. 506, 65 L. Ed. 963, 16 A. L. R. 660.

The statute may, indeed, be said to be an execution of the main design of the Income Tax Act. That it is proper to ignore the value of property at the time of the gift is illustrated by the excess profits tax. A tax upon a donor for making a gift is not in violation of the Constitution. Anderson v. McNeir, 16 F. (2d) 970.

The Supreme Court said, in La. Belle Iron Works v. United States, 256 U. S. 377, 41 S. Ct. 528, 65 L. Ed.

998: "Nor can we regard the act—in basing 'invested capital' upon actual costs to the exclusion of higher estimated values—as productive of arbitrary discriminations raising a doubt about its constitutionality under the due process clause of the Fifth Amendment. The difficulty of adjusting any system of taxation so as to render it precisely equal in its bearing is proverbial, and such nicety is not even required of the states under the equal protection clause, much less of Congress under the more general requirement of due process of law in taxation. Of course, it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

So here Congress, in effect, has said that, notwithstanding the value of the property, from an economic standpoint, for the purpose of this taxation, that value is ignored, and only the value when the property was acquired by the donor is considered. This is deemed necessary to the enforcement of this aspect of the Income Tax Law, where a gift is made, and where a profit or loss is afterwards realized, and it becomes necessary to make proper measurement thereof. Although popularly the gift has a fixed value at the date of transfer, there is no constitutional objection, for income tax purposes, in rejecting or in ignoring that fact, and holding that the rights transferred by the gift, which include the increment while in the hands of the donor, are subject to the tax. No one would have doubted the power of Congress to impose a tax upon the donor at the time of the gift, and the tax could have been measured by the difference between the price he paid for it and its value when [fol. 30] he transferred it. Nor could it be criticized if the donee was left to pay the balance of the tax, based upon the difference between the value on the date of acquisition and the value on the date of sale.

The statute does no more than tax the donee for a gift when he sells it, and measures that income for income tax purposes as based upon the difference between the cost when acquired by the donor and the price realized by the donee. It is not capricious to put property acquired by

gift in a special class, and to tax it differently from property acquired by purchase. Bowman v. Cont. Oil Co., 256 U. S. 642, 41 S. Ct. 606, 65 L. Ed. 1139; Brushaber v. Union Pac. R. R. Co., 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493; Thomas v. U. S., 192 U. S. 363, 24 S. Ct. 305, 48 L. Ed. 481. It is sufficient, for the main purposes of the Sixteenth Amendment and the income tax enactments pursuant thereto, if the method of taxation is consistent with the entire scheme of taxation and the tax imposed by that method may not be considered direct.

We think that Congress, in levying the tax here, was well within its constitutional power in creating a classification which was reasonable, and neither the tax nor the method of enforcing it was arbitrary or capricious. Barclay & Co. v. Edwards, 267 U. S. 442, 45 S. Ct. 135, 348, 69 L. Ed. 703.

The judgments below are reversed, with costs.

Swan, Circuit Judge, dissents.

[fol. 31] In United States Circuit Court of Appeals

[Title omitted]

Concurring Opinion

L. Hand, Circuit Judge (concurring):

In each of these cases the amount of the tax does not exceed the increase in value of the gift while in the donee's hands. Strictly speaking, the question does not therefore arise whether Congress may, as a tax on income, seize any part of the increase in value of the gift before the donee accepted it. I am not entirely sure that a tax, if limited to the increase in the donee's hands, might not be calculated upon the difference between what the donor paid and the donee got. At the argument, I was disposed to think that these cases might be decided on some such reasoning, but it is pretty clear that that would make a new statute. Congress did not mean so to limit the tax. In the first place the results would be so capricious that the validity of the law might be doubtful, and in the second, much revenue would be lost which was certainly intended to be reached. We

may hardly so far strain the law to save it. So I think that this act must be good in whole or not at all.

No increase in value not realized in cash can be taxed as income under the Sixteenth Amendment; that was very deliberately decided in Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. If so, it is impossible to tax the increase in the donor's hands at all; it is not income, though at any time by a sale he could have made it such. The same increase is as little income, even after it has passed to the donee, until he sells. However, it [fol. 32] seems to me equally clear that when he does, there has been a gain which is in every sense income, to the extent of the difference between what the donor paid and the donee got. I am not concerned for the moment with whose gain it is, but that the whole gain is income cannot, I submit, be disputed. If it is important, I suggest that the language of the Amendment itself gives Congress power to lay "taxes on incomes," not on persons. Therefore there is a subject-matter which Congress may tax without apportionment, and part of which, after Eisner v. Macomber, it could not tax in any other way, except perhaps as an excise.

I can see no injustice in regarding the whole of this gain as income of the donee, and if there be no injustice certainly it is not within the Fifth Amendment. Suppose that the law charged the corpus of the gift while in the donor's hands with an inchoate tax at specified rates, to be calculated upon its increase whenever it was sold. The donee in accepting such a gift would take it subject to that charge, though its amount would remain undetermined until he sold. I can see nothing unconstitutional in that, nor in imposing upon him a corresponding duty in personam because of his acceptance. So far as that would involve uncertainty, arising from fluctuation in value of the gift after acceptance, it would be entirely within the donee's control, for he may sell when he likes, and could scarcely complain of any increase which might result from his delay. It is true that Congress has gone further than that, because it has made the whole gain a part of his income for the year in which he sells. But again so far as that is dependent upon the amount of his other income, he can reckon with it when he accepts the gift, and of any subsequent fluctuation he takes

his chance, precisely as he does of fluctuation in the value of the gift.

Therefore I fail to see any oppression in this method of calculating the tax upon what, as I have said, appears to me an unquestionable subject-matter for taxation. In Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087, the gain had accrued before the amendment went into effect. I read Gray v. Darlington, 15 Wall. 63, 21 L. Ed. 45, in the same sense, though perhaps it was only a forerunner of Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. People ex rel. Brewster v. Wendell, 196 App. Div. 613, 188 N. Y. S. 510, dealt with a statute which sought to tax the donor, and was void where Eisner v. Macomber is law. That the statute is reasonably ancillary to a valid constitutional purpose seems to me as plain as in Rice v. Eisner, 16 F. (2d) 358 (C. C. A. 2); that the practice, if permissible, will become a common contrivance to frustrate that purpose, I have no doubt whatever.

I concur with my brother Manton.

[fol. 33] In United States Circuit Court of Appeals

[Title omitted]

Dissenting Opinion

Swan, Circuit Judge (dissenting):

I am unable to agree with the result reached by my colleagues. Section 202 (a) (2) of the Revenue Act of 1921 attempts to include as income of the donee, sustained upon sale of the gift, the increment in value which accrued during the time the property was owned by the donor, or by his predecessor in title if the donor himself received it as a gift. It has been established that Congress may not tax as income what in fact is not income, without apportioning the tax according to the constitutional requirement. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570. Property obtained by gift is capital, not income in the hands of the donee upon its receipt. Edwards v. Cuba Railroad, 268 U. S. 628, 45 S. Ct. 614, 69 L. Ed.

1124; United States v. Oregon-Washington, etc., Co., 251 F. 211 (C. C. A. 2). This is expressly recognized by the declaration of sections 213 (b) (3) of the Revenue Act of 1921 to the effect that gross income shall not include the value of property acquired by gift, but only the income from such property. But section 202 defines the income from such property as including the increment in value which [fol. 34] accrued before the donee became owner of the property. This is an attempt to declare to be income of the donee, when realized by sale of the gift, something which was part of the donee's capital before the sale.

In Doyle v. Mitchell Bros. Co., 247 U. S. 179, 38 S. Ct. 467, 62 L. Ed. 1054, Mr. Justice Pitney, speaking for a unanimous court, said: "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." It was held that, where the increase in capital value occurred before passage of the taxing act, such increase is not taxable as income upon sale of the property. A similar decision as to the Income Tax Act of 1913 (38 Stat. 114) appears in Lynch v. Turrish, 247 U. S. 221, 38 S. Ct. 537, 62 L. Ed. 1087.

I am unable to see why these cases are not applicable. The period under consideration in determining the gain realized by the taxpayer donee is the period of the donee's ownership. Only by giving an unreal valuation to the capital of the donee, namely, the cost of the gift to the donor or his predecessor in title, is it possible to consider the total gain above such cost as income to the donee realized by his sale. It does not seem to me a sufficient answer to say that the donee accepts the gift with knowledge that Congress has declared it to have this fictitious valuation for income tax purposes. The tax is not an excise on the privilege of accepting the gift; it is an income tax, and the tax payer's income must be a gain derived from his capital, or his labor, or from both combined.

It is my opinion, therefore, that the judgments should be affirmed.

[fol. 35] In United States Circuit Court of Appeals

[Title omitted]

Decree—Filed July 13, 1927

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed with costs. Further ordered that execution be issued for the collection of said costs.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

M. T. M. L. H.

[fol. 36] [File endorsement omitted.]

[fol. 37] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 38] Supreme Court of the United States

Order Allowing Certiorari—Filed November 21, 1927

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Chief Justice Taft took no part in the consideration or decision of the petition for writ of certiorari in this case.